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SUBJECT: Growth amid the Gloom - Some Companies Still Prospering in the Pearl River Delta

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[1](#)1. (SBU) Summary and Comment: Factories are closing and migrant workers are unemployed, but there are still success stories in the Pearl River Delta (PRD). While the city of Dongguan with its heavy concentration of Hong Kong and Taiwan investment in labor-intensive export manufacturing has been hit hard, Chinese companies like Galanz, Gree and Midea, with production based on the west bank of the Pearl River in cities like Foshan, Zhongshan and Zhuhai, continue to grow. Their healthy mix of domestic and export sales has allowed them to escape much of the pain that export manufacturers felt after the dramatic decline in orders for the U.S. and European markets. Meanwhile, they've expanded further in markets like Southeast Asia, the Middle East and Africa and have moved further up-market, increasing margins with more expensive products. Some executives even see potential benefits from the downturn as industry consolidation eliminates competitors.

[1](#)2. (SBU) The examples of these three firms further underscore the fact that the economic picture in the PRD is more complex than some of the one-sided media reports that only describe factory closures and declining export orders. Many firms have been able to use sales to the China market to drive continued growth. Gree, Galanz and Midea are not the only examples; some American firms that have penetrated the China market like Procter and Gamble also continue to grow, albeit at a slower rate (ref B). We expect restructuring and consolidation to continue among manufacturing industries in Guangdong, especially among firms focused entirely on export production that are unable to adapt to new conditions and target consumers in China and other emerging markets. However, the PRD is not turning into a factory ghost town, and it will continue to be a critical global manufacturing center. End summary and comment.

Looking to Grow in 2009

[1](#)3. (SBU) The news has been mostly bad for export-reliant Guangdong Province in the aftermath of the global financial crisis. But there are a few bright spots amid the gloom. Firms like Galanz, Gree and Midea, all Chinese-owned appliance manufacturers located on the west

side of the Pearl River Delta, have not only weathered the storm but are predicting growth this year. Gree, which manufactures only air-conditioners, has already seen first quarter revenue rise 15.9 percent in 2009 with profits for the quarter up by approximately 50 percent, according to executives at the firm's headquarters in Zhuhai. Midea executives told us they expect the firm, which produces a wide range of household appliances, to see revenue of RMB 98 billion (USD 14.4 billion) in 2009, up from RMB 90 billion (USD 13.2 billion) in 2008. Galanz, which dominates the global microwave oven manufacturing industry, has already begun to see orders begin to recover after dropping dramatically in the first quarter. Company executives said they believe that June 2009 sales would match sales from a year ago and expect further recovery the rest of the year.

Feeling the Impact Overseas

14. (SBU) These firms did not completely escape the impact of the global financial crisis. Each saw orders from the important U.S. and European markets plummet after the crisis began last year. According to company executives, Gree saw sales to the United States, its largest foreign market, fall by 15-20 percent. Galanz saw U.S. and European sales both fall by about 20 percent with an overall decline in export sales of 10 percent year-on-year in the first quarter. An overseas marketing manager at Midea told us that, with the United States and Europe accounting for more than 60 percent of the firm's export sales, the impact of the global financial crisis had been considerable, especially in product categories mostly closely related to the construction industry like dishwashers and air-conditioners. In addition to falling orders,

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the risk of non-payment has increased with rising numbers of bankruptcies in the United States. A Galanz executive noted that the firm almost suffered a USD 1 million loss in payments after a Miami importer went out of business. (Fortunately for Galanz, the transaction was insured.)

But Expanding Territory and Moving Up Market

15. (SBU) Damage from declining orders in the United States and Europe was mitigated by growth in exports to other regions. Galanz has seen export sales to the Middle East, Africa, and South and Central America continue to rise throughout the crisis. Gree saw particularly strong export growth to the Middle East/Africa region, which has become its second largest export market. Midea executives noted rising sales to Africa and Southeast Asia.

16. (SBU) Some of these rising sales to regions other than the United States and Europe also represent higher margins for the appliance makers. Each of the firms estimated that approximately 90 percent of export sales overall were original equipment manufacturing (OEM) sales produced under contract for international brand name buyers. The percentage is significantly higher in the U.S. and most European markets, where the Galanz, Gree and Midea brand names are practically unknown. However, the three firms have had some success in penetrating emerging markets with their own brand name products. Gree executives claimed that their products enjoyed a 15 percent market share in Pakistan, 10 percent in Vietnam and were the second highest selling brand of air-conditioner in Brazil.

17. (SBU) The firms have also made some effort to increase profits by producing more advanced and higher value products. Gree and Galanz executives each told us that their firms spend approximately 3 percent of revenue on research and development. Galanz also noted that they had implemented a new strategy in the U.S. and European markets to increase margins at the expense of unit sales volumes. In June of July 2008, the firm raised its prices for U.S. and European buyers by 7-8 percent. This caused a drop in unit sales that preceded the most severe period of the global financial crisis. The firm lost major orders from Wal-Mart and Carrefour, but the strategy successfully raised sales margins.

Growing at Home

¶18. (SBU) However, the most critical advantage these firms have enjoyed over many other export manufacturers in the Pearl River Delta is their impressive success in dominating certain segments of the Chinese appliance market. Galanz maintains a 60 percent market share in microwaves. As is true for the other two firms, nearly all of its China sales are its own brand-name products. China sales account for approximately two-thirds of the firm's revenues. The executives noted that domestic market growth for their products is strong; China's microwave sales were 10-11 million units in 2008 and are expected to rise to 14-15 million units in 2009. They believe there is much potential for further growth with rising sales in third and fourth-tier cities, where microwaves are still relatively rare.

¶19. (SBU) Midea executives gave a similar assessment. The firm earns 60 percent of its revenue from domestic Chinese sales. The executives noted that the air-conditioner and refrigerator markets in China continue to grow as sales spread to small and medium-sized cities. Although the firm is by no means abandoning the export market, it is mobilizing more resources toward production and marketing aimed at Chinese consumers, according to the executives.

¶10. (SBU) Gree's revenues are even more heavily dependent on the Chinese market, accounting for 70 percent of global sales. It dominates domestic air-conditioner sales with a 40-45 percent market share. The company's projections for growth in its unit sales of air-conditioners in China are not as optimistic; last year it sold 23.2 million units and predicts only 23 million for 2009. However, the executives told us that they are starting to see signs of recovery in the domestic real estate market, which they believe will

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help drive future sales growth.

Crisis as Opportunity

¶11. (SBU) Executives from the three firms pointed to some benefits from the global economic downturn as well. Gree executives said that they expected their market share in China to increase as falling orders force some competitors out of businesses. Midea and Galanz executives both claimed that the government's stimulus programs aimed at increasing consumption in rural areas had boosted sales of their products.

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